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JEI REPORT

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OECD And EPA Highlight Japan's Budget Surplus

The description could be straight out of a news story from either Tokyo or Washington: a large surplus in social security masks a huge deficit in the central government's operations. The budget situation, in other words, is not nearly as good as it looks. In Washington the situation as described has led to substantial handwringing and even a proposal to reduce taxes going into the social security trust fund. The apparent hope is that the unmasked government deficit figure would somehow stimulate calls for an offsetting tax increase to finance ordinary federal government expenditures, leaving the overall budget deficit unchanged.

In Tokyo, however, the situation looks more like an embarrassment of riches. While the central government's budget remains in deficit, the size of that imbalance has declined from about 6 percent of gross national product in fiscal 1979 (ended March 31, 1980) to an estimated 2 percent in FY 1988. As a result, the combined deficit of the central government, the social security fund and local governments shrank dramatically during the early and mid-1980s; in FY 1987 the aggregate deficit was replaced by a surplus. In a so-called

into such areas as real estate investment trusts and developing new instruments based on options and futures, the American units of the Big Four brokerage houses -- Nomura Securities Co., Ltd., Yamaichi Securities Co., Ltd., Daiwa Securities Co., Ltd. and Nikko Securities Co., Ltd. -- all reported profits for the last half of 1989. After realizing that their traditional way of doing business (large volume, low-margin trading) did not match U.S. markets, they have moved quickly into new fields. (Interestingly, Japanese subsidiaries of American securities firms have enjoyed increasing success in Japan by offering the same advice to Japanese investors as they do in the United States -- buy and sell recommendations based on exhaustive market research.)

It is unlikely that U.S. or domestic pressure for further changes in Japan's financial markets will diminish since many issues remain unresolved. MOF is finding it increasingly difficult, however, to find a compromise that balances the myriad of competing interests.

Jon Choy

Tokyo Pledges Final ODA Loan To Seoul

Tokyo pledged to Seoul this month the final $690 million installment of a $1.85 billion, seven-year aid package, comprised totally of loans on concessional terms. The new money will be used to expand Seoul's subway system. The exact terms of the lending -- which Japan will administer through the Overseas Economic Cooperation Fund -- will be determined during a fact-finding mission to South Korea. Tokyo indicates that it will not give Seoul any new concessional loans because, as one of the newly industrialized economies, South Korea anticipates being graduated to the status of developed nation in the near future.

The recently announced loan is part of a larger FY 1983-FY 1989 $4 billion economic assistance program for South Korea. The $4 billion deal was concluded following negotiations between the two governments regarding Seoul's $6 billion economic assistance request in 1981. The Export-Import Bank of Japan originally was to extend $2.15 billion worth of loans to South Korea as other official flows -- including funds for export credits and direct investment -- rather than as official development assistance. South Korea had applied for the funding to offset the negative effects of rising oil prices and heavy defense expenditures -- which, in part, play a role in regional defense benefiting Japan, Seoul argued.

However, Ex-Im Bank has made only two loans to South Korea. In December 1983 it committed $42.1 million; four years later it committed another $29 million. The bank has indicated that it is unlikely to pledge new funding to South Korea since economic progress there makes such concessional lending unnecessary. Moreover, just 63 percent of the $1.85 billion in planned OECF loans had been committed by the end of FY 1987 (see Table 1). Due to the strength of its economy in FY 1988 South Korea received no additional loans that year.

Since 1981 when Seoul's net borrowing totaled $288.5 million, it has been a net repayer of loans to Tokyo every year (see Table 2). In the last decade South Korea has received almost no outright grants, although it does continue to receive technical cooperation, considered to be a grant. Technical cooperation has continued to increase every year, surging from $6.2 million in

Table 1: New Loan Commitments to South Korea by Japan, 1980-88

(in millions of dollars)

Year	Amount
1980	$83.8
1981	--
1982	--
1983	189.9
1984	208.4
1985	228.1
1986	264.9
1987	--
1988	212.7

Source: Ministry of Foreign Affairs

Table 2: Japan's Official Development Assistance to South Korea, 1980-88*

(in millions of dollars)

	Grants			
Year	Grant Aid	Technical Cooperation	Loans	Total
1980	---	$6.2	$70.1	$76.3
1981	$0.0	7.0	288.5	295.6
1982	---	8.3	-4.4	3.8
1983	---	9.2	-15.9	-6.6
1984	0.1	11.2	-59.4	-48.1
1985	---	15.1	-19.6	-4.4
1986	---	21.8	-35.5	-13.8
1987	0.2	29.2	-22.8	6.6
1988	---	35.6	-23.1	12.6

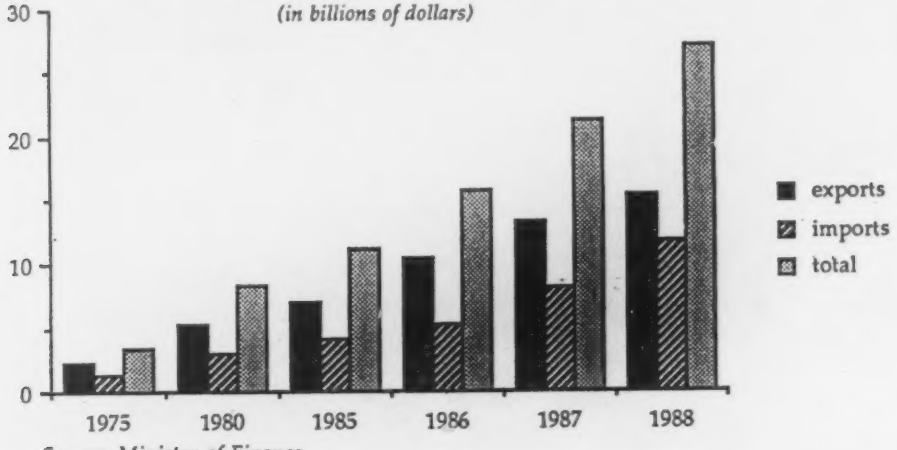
*Net disbursement basis.

Source: Ministry of Foreign Affairs

1980 to $35.6 million in 1988. This rise, in part, reflects the depreciation of the dollar relative to the yen from late 1985 through 1988. The value of the South Korean won is pegged to the U.S. dollar.

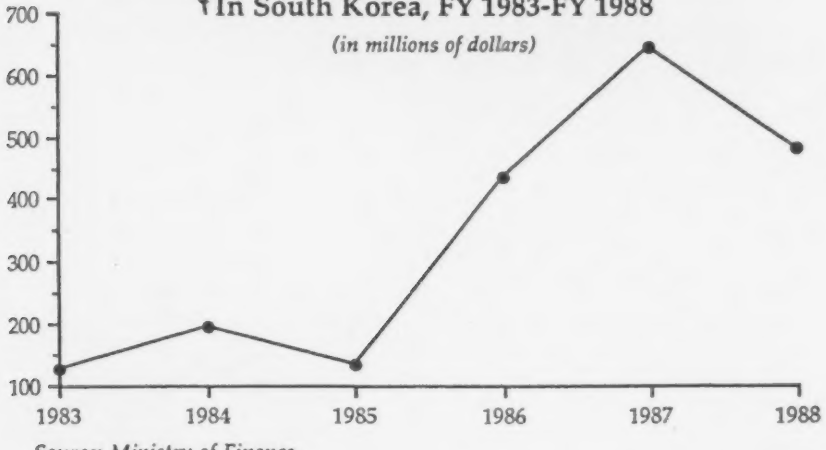
The price competitiveness of South Korea's exports to Japan also benefited from the strengthening of the yen following the September 1985 Plaza Accord agreement. Trade between the two countries has soared in the past decade, reaching $27.3 billion in 1988 (see Chart 1). Japan's imports from South Korea almost tripled, going from $4.1 billion in 1985 to $11.8 billion in 1988. Exports hit $15.4 in 1988 from $7.1 billion three years earlier, resulting in a smaller Japanese surplus. Japan's foreign direct investment in South Korea also has increased significantly since 1985 (see Chart 2). The investment outflow in FY 1988 was $483 million, roughly triple the FY 1985 level (see JEI Report No. 26A, July 27, 1989).

Chart 1: Japan's Trade With South Korea



Source: Ministry of Finance

Chart 2: Japan's Foreign Direct Investment In South Korea, FY 1983-FY 1988



Source: Ministry of Finance

Japanese lending over the last decade has helped strengthen South Korea's infrastructure, which has resulted not only in a more competitive trade partner but a country more able to extend its help to others, both as a model and financially. Reflecting the progress, Seoul has created its own program to administer foreign aid to developing countries. With the final loan of Japan's economic assistance package in place, Tokyo and Seoul in the 1990s will enter a new phase in their economic relations.

Gretchen Green

reports indicate that public support for the ruling party has declined due to the LDP's failure to reform the controversial 3 percent consumption tax in a way that is more attractive politically than the opposition parties' proposal to abolish it outright. The LDP's plan would eliminate the tax on food at the retail stage and reduce it to 1.5 percent at the farm and the wholesale levels (see JEI Report No. 46B, December 8, 1989).

In any event, Mr. Kaifu will not have much time to ruminate over the soundness of his decision to go to Europe. Immediately after his January 18 return to Tokyo, the prime minister had to hit the ground running to orchestrate enactment of the FY 1989 supplemental budget. From the end of January, when he is expected to dissolve the lower house, through February 17 Mr. Kaifu probably will face the rigors of the campaign trail, a time when he will learn firsthand how the populace would like Japan to be ruled.

Barbara Wanner

Tokyo Expected To Extend Car Export Limits

Strictly political. That is the only way to describe Tokyo's decision in early 1988 and again at the start of 1989 to keep Japan's U.S.-bound car exports capped at 2.3 million units a year. All of the economic factors weighed by Ministry of International Trade and Industry policymakers in early 1988 and again at the start of 1989 pointed to the opposite move -- an end to managed trade in cars. Admittedly, 1987 and 1988 sales of cars built in North America by General Motors Corp., Ford Motor Co. and Chrysler Corp. were below the figure for 1985, the industry's best year in the 1980s, but they were considered fairly robust given the number of vehicles that had been sold in the American market since 1982. Support for this judgment was no farther away than the Big Three's record-shattering 1988 profits and 1987's near miss, including significant profits in both years from U.S. automotive operations.

Japan's export figures were additional proof that the shipment limit, in effect since April 1981, had become economically irrelevant. Exports came in 3.7 percent below the quota during the April 1987-March 1988 period; in the 12 months through March 1989 the shortfall was even larger -- 5.3 percent. Mirroring this cutback, U.S. sales of Japanese-made cars declined in 1987 from 1986's all-time high and fell again in 1988. Adding in the expanding volume of cars assembled in this country by Japanese automotive makers obviously changed the sales numbers and market share figures for Japanese nameplates (see Table 1) but not the conclusion that the economic rationale for restricted competition in cars had long since disappeared.

Exports are expected to fall at least 10 percent short of the cap in the current fiscal year. Shipments in the April-November 1989 period were running 13 percent below their scaled-back 1988 level, and with two-thirds of the restraint period already behind them, Japanese automotive producers had filled only 56 percent of the quota. Perhaps even more significantly, all nine exporters are said to be having trouble supplying their full allotment, not just Nissan Motor Co., Ltd., which accounted for most of the export shortfall in both FY 1987 and FY 1988.

In deciding last year to extend the shipment restraints through March 1990, MITI officials held out the possibility that the export ceiling would be

Table 1: U.S. Retail Car Sales, 1983-89

(units)

Manufacturer/Seller	1983	1984	1985	1986	1987	1988	1989
Japanese Imports							
Toyota Motor Corp. (incl. Lexus)	555,766	557,981	620,047	633,914	583,809	616,529	511,271
Nissan Motor Co., Ltd. (incl. Infinity)	521,902	485,298	535,372	494,294	409,476	360,745	406,870
Honda Motor Co., Ltd. (incl. Acura)	350,670	374,819	406,413	458,268	421,688	393,360	393,630
Mazda Motor Corp.	173,388	169,666	211,093	222,676	206,354	224,719	221,794
Fuji Heavy Industries, Ltd. (Subaru)	156,840	157,385	178,175	179,100	175,864	155,946	136,112
Mitsubishi Motors Corp.	32,755	39,104	49,734	49,436	67,954	69,975	79,751
Isuzu Motors Ltd.	20,731	17,233	26,953	38,910	39,587	24,520	16,296
Daihatsu Motor Co., Ltd.	0	0	0	0	0	11,460	15,118
Suzuki Motor Co., Ltd.	0	0	0	0	0	524	6,009
Mitsubishi Motors Corp./Chrysler Corp.	103,569	91,718	105,213	135,528	120,337	113,800	98,324
Isuzu Motors Ltd./General Motors Corp.	0	2,077	53,593	99,380	76,852	68,347	62,232
Suzuki Motor Co., Ltd./General Motors Corp.	0	10,927	31,267	60,983	60,359	48 088	53,437
Domestic Makes							
General Motors Corp.*	4,053,561	4,587,508	4,607,458	4,532,798	3,555,538	3,641,542	3,276,941
Ford Motor Co.**	1,571,321	1,979,317	2,070,392	2,066,507	2,019,783	2,205,336	2,099,773
Chrysler Corp.***	841,622	986,998	1,139,936	1,173,463	962,057	1,062,782	917,506
American Motors Corp.	193,351	190,255	123,449	72,848			
Volkswagen of America Inc.	85,045	73,838	77,535	73,912	61,064	24,939	0
Honda of America Manufacturing, Inc.	50,402	133,601	145,976	235,247	316,618	375,625	389,472
New United Motor Manufacturing Inc./ General Motors Corp.	0	0	35,594	170,507	134,956	96,868	89,875
New United Motor Manufacturing Inc./ Toyota Motor Sales USA Inc.	0	0	0	7,281	44,853	57,637	****
Nissan Motor Manufacturing Corp. U.S.A.	0	0	39,794	52,602	119,678	112,125	103,134
Mazda Motor Manufacturing (USA) Corp./ Mazda Motor of America, Inc.	0	0	0	0	1,671	31,331	41,584
Mazda Motor Manufacturing (USA) Corp./ Ford Motor Co.	0	0	0	0	0	77,763	133,650
Toyota Motor Manufacturing, U.S.A., Inc.	0	0	0	0	0	14,717	****
Diamond-Star Motors Corp./ Mitsubishi Motor Sales of America, Inc.	0	0	0	0	0	0	32,018
Diamond-Star Motors Corp./ Chrysler Corp.	0	0	0	0	0	0	28,243
Domestic Makes Built by Big Three	6,659,855	7,744,078	7,905,641	7,675,109	6,402,422	6,735,029	6,042,452
Domestic Makes Built by Japanese Affiliates	50,402	133,601	221,364	465,637	617,776	766,066	1,030,364
Total Japanese Imports	1,915,621	1,906,208	2,217,860	2,372,489	2,162,280	2,088,013	2,000,844
Total Imports	2,385,734	2,441,713	2,841,063	3,239,043	3,144,048	3,065,073	2,794,598
Total Domestic Makes	6,795,302	7,951,517	8,204,721	8,214,662	7,081,262	7,526,034	7,072,816
Total Market	9,181,036	10,393,230	11,041,784	11,453,705	10,225,310	10,591,107	9,867,414
Market Share of Japanese Imports	20.9%	18.3%	20.1%	20.7%	21.2%	19.7%	20.3%
Market Share of Japanese Imports and Domestic Makes Built by Japanese Affiliates	21.4%	19.6%	22.1%	24.8%	27.2%	26.9%	30.7%

*Starting in 1985 includes the Geo Nova/Prizm made by New United Motor Manufacturing Inc.
**Starting in 1988 includes the Ford Probe made by Mazda Motor Manufacturing (USA) Corp.
***Starting in 1989 includes the Plymouth Laser and the Eagle Talon made by Diamond-Star Motors Corp.
****Combined sales were 212,388 units.

Source: Automotive News

lifted before then if deliveries declined over a sustained period (see JEI Report No. 3B, January 20, 1989). That precondition was met some time ago, but the ministry is even less inclined to end the limits this year than it was a year ago. The reason is simple: rapidly changing conditions in the U.S. car market have added an economic dimension to what had been a strictly political issue.

Despite the almost nonstop use of incentives, sales of cars assembled in North America by the Big Three tumbled 10.3 percent in 1989 to 6 million units, the industry's worst performance since the recession year of 1982. Sales of imported Japanese nameplates also fell last year, but that 3.8 percent drop to under 1.9 million cars was small consolation to GM, Ford and Chrysler, which are expected to report losses on their U.S. automotive operations for 1989's second half and possibly for the full year despite remaining profitable overall. For one thing, the American marketing units of Japanese motor vehicle makers retailed almost 2.6 million domestically built and imported cars, 4.7 percent more than 1988's then-peak tally; in the process they won a record 26 percent of total U.S. sales, up from the 23.1 percent market share gained the year before. To boot, the Honda Accord was the best-selling car in the United States in 1989, the first time a Japanese-designed model took top honors.

Although overall U.S. car demand was soft in 1989, the market did not experience the downturn that a number of industry forecasters had predicted. This year, however, could be a different story, judging by its rocky start. All three American automotive companies have announced temporary closings for most of their U.S. and Canadian plants during the first quarter and slower line speeds at the ones still operating in an effort to slice bulging inventories of unsold cars. The eight Japanese-affiliated assembly plants in the United States are not immune to the sales slowdown, but reports of widespread layoffs in Big Three plants are creating difficult public relations problems for the transplants. Previously polite talk in the industry about these factories "displacing" sales by Detroit is being replaced by charges of "stealing" as the transplants expand their output and GM, Ford and Chrysler trim their operations (see Table 2).

Given the pessimistic projections for Big Three car sales in 1990, U.S. industry executives and automotive-state representatives on Capitol Hill have been surprisingly quiet about Japan's export restraints after March. Only the United Auto Workers union has pressed MITI to extend the quota for another year and it did that in mid-December with a minimum of publicity. This low profile has at least one obvious explanation: everyone concerned assumes that MITI will keep the restraints in place since abandoning them now would add fuel to the protectionist fires in the United States while not changing U.S. market opportunities for Japanese exporters.

This reasoning was on target. At JEI press time MITI Minister Hikaru Matsunaga disclosed that the export restraints would be kept in place for a tenth year. The January 17 announcement was a replay of 1989's. Saying that the government wanted to make sure exports were on the downswing before it removed the cap, Mr. Matsunaga added that the restrictions could be eliminated sooner than March 1991 if shipments continued to drop. The reaction at home and abroad also had a familar ring. GM and Chrysler spokemen dismissed the extension as a symbolic gesture, while Ford executives welcomed it. Japanese exporters also were divided, with some resigned to continued restraints and others expressing disappointment, at least for the record.

Table 2: U.S. Car Production (Commercial), 1987-89

(units)

	1987	1988	Estimated 1989	1990 Car Capacity
Honda of America Manufacturing, Inc. (Marysville, OH)	324,064	366,355	361,660	360,000
Honda of America Manufacturing, Inc. (East Liberty, OH)	0	0	0	65,000
New United Motor Manufacturing Inc. (Fremont, CA)	187,378	128,430	192,525	250,000
Nissan Motor Manufacturing Corp. U.S.A. (Smyrna, TN)	117,334	109,897	115,584	130,000*
Mazda Motor Manufacturing (USA) Corp. (Flat Rock, MI)	4,200	163,289	205,141	240,000
Toyota Motor Manufacturing, U.S.A., Inc. (Georgetown, KY)	0	18,527	151,122	200,000
Diamond-Star Motors Corp. (Normal, IL)	0	0	92,777	240,000
Subaru-Isuzu Automotive Inc. (Lafayette, IN)	0	0	6,029	60,000**
Total Japanese-Affiliated Plants	632,977	786,498	1,124,838	1,545,000
Volkswagen of America Inc.	66,696	35,997	0	
General Motors Corp.	3,455,463	3,427,276	3,100,162	
Ford Motor Co.	1,830,446	1,806,802	1,677,979	
Chrysler Corp.	1,109,411	1,072,845	915,103	
Total U.S. Output	7,094,993	7,129,420	6,818,081	
Japanese Share	8.9%	11.0%	16.5%	

*Plant's total capacity is 265,000 units a year, divided about equally between cars and compact pickup trucks.
**Plant's total capacity is 120,000 units a year, divided about equally between cars and compact pickup trucks.

Source: Automotive News

Susan MacKnight

Notes

Japan-China - The January 10 end of seven months of martial law in Beijing was greeted cautiously in Tokyo and Washington by government officials and businessmen alike. The Bush administration and the cabinet of Prime Minister Toshiki Kaifu welcomed the change but insisted that Beijing must take more substantive steps toward economic and political reform before relations return to

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JEI

REPORT

A Two-Part Report: A and B

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JAPAN'S PRICE STRUCTURE

Summary

When a New Yorker visits Tokyo, whether on business or for pleasure, he begins to feel that every charge -- from dining to taxis -- is more expensive than at home. Similarly, increasing numbers of Japanese tourists confess that most products and services cost less in this country than in Japan. Although price differences between the two countries depend on what is bought and where, the hard fact is that the prices of many goods and services are relatively higher in Japan than in the United States. During the Structural Impediments Initiative talks American officials have cited Japan's pricing system as a nontariff barrier that limits exports to the world's second-largest economy.

Since a country's price structure is affected by many factors, such as its natural resources endowment, government regulations, business practices and consumer behavior, the best way to analyze it is to divide the economy into four sectors: public services, regulated services, regulated imports and tradable goods. In Japan a scarcity of natural resources is among the factors that help push up prices of public services. Excessive regulations make price competition difficult in Japan's service sector. Import restrictions boost retail prices for beef, oranges and rice. Moreover, the prices of tradable goods in Japan are higher than they otherwise might be because of corporate pricing strategies and the distribution network. Finally, a cultural emphasis on gift-giving and the business community's huge entertainment expenses exacerbate the situation.